Testimony of

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On behalf of

The National Association of Federal Credit Unions

"Oversight of the Small Business Administration's Financing Programs"

Before the

House Small Business Committee

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Introduction

Good afternoon, Chairman Graves, Ranking Member Velazquez and Members of the Committee. My name is Gary Grinnell, and I am testifying today on behalf of the National Association of Federal Credit Unions (NAFCU). Thank you for holding this important hearing today. I appreciate the opportunity to share my views on the Small Business Administration's financing programs.

I have been with Corning Credit Union since 1997 and have served as President/CEO since 2007. Corning Credit Union was founded in 1936 in Corning, NY in an effort to keep Corning Glass Works employees from being victimized by street-corner lenders. Today, we have over 79,000 members and $896 million in assets. We have 250 employees and 17 branches in New York, Pennsylvania and in the Wilmington, North Carolina area.

As you may know, NAFCU is the only national organization that exclusively represents the interests of the nation's federally chartered credit unions. NAFCU is comprised of nearly 800 member-owned and operated federal credit unions. NAFCU member credit unions collectively account for approximately 62 percent of the assets of federally chartered credit unions. NAFCU and the entire credit union community appreciate the opportunity to participate in this discussion regarding financing programs under the Small Business Administration.

Background on Credit Unions

Historically, credit unions have served a unique function in the delivery of necessary financial services to Americans. Established by an act of Congress in 1934, the federal credit union system was created, and has been recognized, as a way to promote thrift and to make financial services available to all Americans, many of whom would otherwise have limited access to financial services. Congress established credit unions as an alternative to banks and to meet a precise public need—a niche credit unions fill today for nearly 93 million Americans. Every credit union is a cooperative institution organized “for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes.” (12 § USC 1752(1)). While over 75 years have passed since the *Federal Credit Union Act* (FCUA) was signed into law, two fundamental principles regarding the operation of credit unions remain every bit as important today as in 1934:

- credit unions remain totally committed to providing their members with efficient, low-cost, personal financial service; and,
- credit unions continue to emphasize traditional cooperative values such as democracy and volunteerism. Credit unions are not banks.

The nation’s approximately 7,200 federally insured credit unions serve a different purpose and have a fundamentally different structure than banks. Credit unions exist solely for the purpose of providing financial services to their members, while banks aim to make a profit for a limited number of shareholders. As owners of cooperative financial institutions united by a common bond, all credit union members have an equal say in the operation of their credit union—“one member, one vote”—regardless of the dollar amount they have on account. These singular rights extend all the way from making basic operating decisions to electing the board of directors—something unheard of among for-profit, stock-owned banks. Unlike their counterparts at banks and thrifts, federal credit union directors generally serve without remuneration—a fact epitomizing the true “volunteer spirit” permeating the credit union community.

Credit unions continue to play a very important role in the lives of millions of Americans from all walks of life. As consolidation of the commercial banking sector has progressed, with the resulting depersonalization in the delivery of financial services by banks, the emphasis in consumers’ minds has begun to shift not only to services provided, but also—more importantly—to quality and cost of those services. Credit unions are second-to-none in providing their members with quality personal financial services at the lowest possible cost.

Artificial Member Business Lending Cap at Credit Unions Hurts Small Business

When Congress passed the *Credit Union Membership Access Act* (CUMAA) (P.L.105-219) in 1998, it put in place restrictions on the ability of credit unions to offer member business loans. Credit unions had existed for nearly 90 years without these restrictions. Congress codified the definition of a member business loan and limited a credit union’s member business lending to the lesser of either 1.75 times the net worth of a well-capitalized credit union or 12.25 percent of total assets.

CUMAA also established, by definition, that business loans above $50,000 count toward the cap. This number was not indexed and has not been adjusted for inflation in the more than 13 years since enactment, eroding the *de minimis* level. Where many vehicle loans or small lines of credit may have been initially exempt from the cap in 1998, many of those that meet the needs of small business today, are now included into the cap due to this erosion. To put this in perspective relative to inflation, what cost $50,000 in 1998 costs $69,500 today, using the August consumer price index data. That is a 39% rate of inflation change that is completely ignored by current law and which greatly hamstrings a credit union's ability to meet its members' needs.

It should be noted that the government guaranteed portions of SBA loans do not count toward the member business lending cap, but the non-guaranteed portions do. This could ultimately lead to a situation where a credit union may be an excellent, or even preferred, SBA lender and ultimately have to scale back participation in SBA programs as they approach the arbitrary cap. This would likely hit SBA Express or Patriot Express loans first, as those have lower guarantees and thus may have a bigger impact on money available below the cap.

Also, pursuant to section 203 of CUMAA, Congress mandated that the Treasury Department study the issue of credit unions and member business lending. In January 2001, the Treasury Department released the study, "Credit Union Member Business Lending" and found the following: "…credit union's business lending currently has no effect on the viability and profitability of other insured depository institutions." (p. 41). Additionally, when examining the issue of whether modifying the arbitrary cap would help increase loans to businesses, the study found that "…relaxation of membership restrictions in the Act should serve to further increase member business lending…" (p. 41).

The 2001 Treasury study found that credit unions do not pose a threat to the viability and profitability of banks, but that in certain cases, they could be an important source of competition for banks. It is important to note that credit unions have a nominal market share of the total commercial lending universe (approximately 5% of all small business loans from insured depository institutions), and are not a threat to banks (who control nearly 95% of all small business loans from insured depository institutions) in this environment.

A 2011 study commissioned by the SBA's Office of Advocacy affirms these findings. (James A. Wilcox, *The Increasing Importance of Credit Unions in Small Business Lending*, Small Business Research Summary, SBA Office of Advocacy, No. 387 (Sept. 2011)). The SBA study also indicates, importantly, that credit union business lending has increased in terms of the percentage of their assets both before and during the 2007-2010 financial crisis while banks' has decreased. This demonstrates not only the need for lifting the MBL cap in order to meet credit union members' demand, but also that credit unions continued to meet the capital needs of their business members even during the most difficult of times. One of the findings of the study was that bank business lending was largely unaffected by changes in credit unions' business lending. Additional analysis in the study also found that credit unions' business lending can actually help offset declines in bank business lending during a recession.

Bipartisan legislation to address this issue, in the form of H.R. 1418, the *Small Business Lending Enhancement Act*, is pending before the Financial Services Committee. We would urge Committee members to support this important bill.

SBA Lending at Corning Credit Union

At Corning Federal Credit Union (CCU) we have a well-diversified business lending portfolio with minimal delinquencies (a delinquency ratio of 0.36%). Our commercial losses have also been minimal as we have an experienced lending staff and a sincere and devoted membership. For the last two years, we have been recognized as the top small community lender by the Small Business Administration in the 34 counties that make up the SBA district (Syracuse) in which we are located.

We started our business services program in 2006 in response to demand from our existing membership, and CCU has been an important source of funding for existing, new and growing businesses in the Southern Tier and Finger Lakes region of New York, and the greater Wilmington area of North Carolina. We took a planned and deliberative approach toward starting our program, hiring an outside consultant to help us explore the opportunity and put a detailed, strategic plan together. We have deliberately hired experienced commercial lenders and business services professionals from outside the organization. We have added jobs over the past several years to support our growth and member demand, and now have commercial loan officers, credit analysts, business development officers, supervisors, administrative and business account specialists on staff. During the recent economic downturn, banks in our markets, particularly in the Wilmington area, stopped lending to their clients. CCU has been able to fill the void and provide these businesses with the funding they need to continue to grow and create jobs as the demand has not subsided.

To increase the products available and provide more options for our field of membership, Corning became an SBA lender when we started our member business lending program. SBA products allow us to leverage our lending dollars and extend more credit to our communities' small businesses.

Since our SBA program's inception, we have made 71 loans totaling over $8.2 million in SBA lending. Our average SBA loan is about $116,000. Corning participates in the SBA 7(a), SBA Express and Patriot Express loan programs. 7(a) eligible use of funds include purchasing commercial real estate, equipment, inventory, working capital, etc., while the Patriot loan program is designed to create opportunities specifically for veterans and members of the military community wanting to establish or expand small businesses.

At Corning Credit Union we strive to strengthen our communities by offering our members new entrepreneurial opportunities. Many of our SBA loans are for entrepreneurs wanting to start a new business and create new jobs.

For example, in 2007, one of our members in upstate NY had a dream of starting up her own pet care business. She worked with the local small business development center to create a comprehensive business plan. She approached a large bank for startup capital, but they had no interest in the loan. Based on a recommendation from another business owner, she approached CCU. Thinking creatively and with the help of the US Small Business Administration, we were able to put together a package of financing to help this member get her dream off the ground. CCU has since assisted her as her business has grown at a rate of 18-20% per year. She has expanded the business with additional services and added half a dozen jobs to the local community.

There are many more stories, like this one, of small business owners looking for that loan to enable them to start their business. The demand is out there. Unfortunately, in this current environment, many banks have scaled back their lending. At Corning Credit Union, we are pleased that we have been able to help step up to meet this pent-up demand.

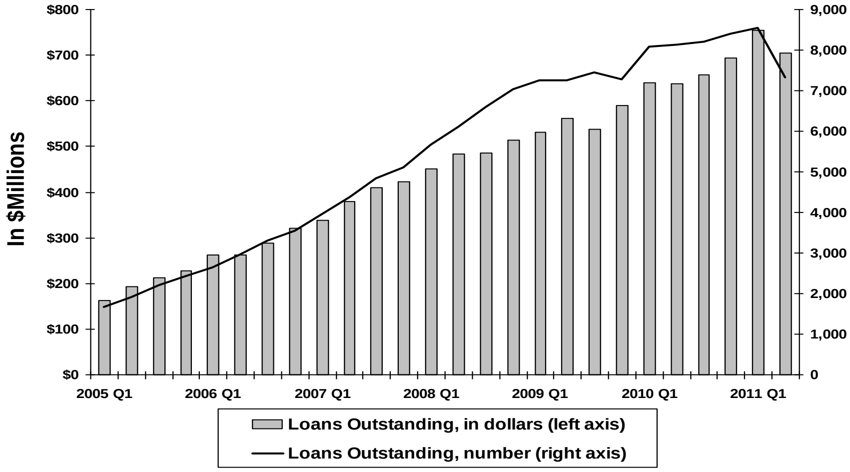
SBA and Access to Capital for Credit Union Members

Small businesses are the backbone of our economy and an important source of jobs for Americans. The Small Business Administration's loan programs serve as an important resource that helps credit unions provide small businesses with the vital capital necessary for growth and job creation. However, utilizing any SBA loan guaranty program requires meeting stringent government regulations.

Determining overall applicant eligibility to participate in an SBA program is nearly as important as determining the applicant's creditworthiness. Failing to meet certain eligibility criteria may preclude the applicant from participating in an SBA guaranteed loan program. Eligibility criteria includes among other things: size restrictions, type of business, use of proceeds, credit standards, and meeting a 'credit-elsewhere' test.

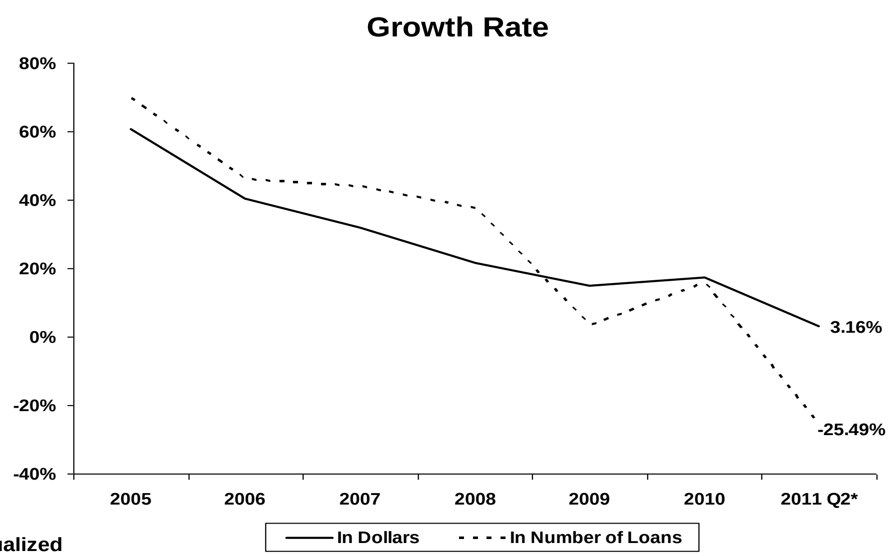
While credit union SBA loans have generally increased in both total number and dollars, the growth rate of credit union SBA lending has fallen during the recession (see charts below).

FICU SBA Loans



Source: NCUA

FICU SBA Loans



* Annualized

Source: NCUA

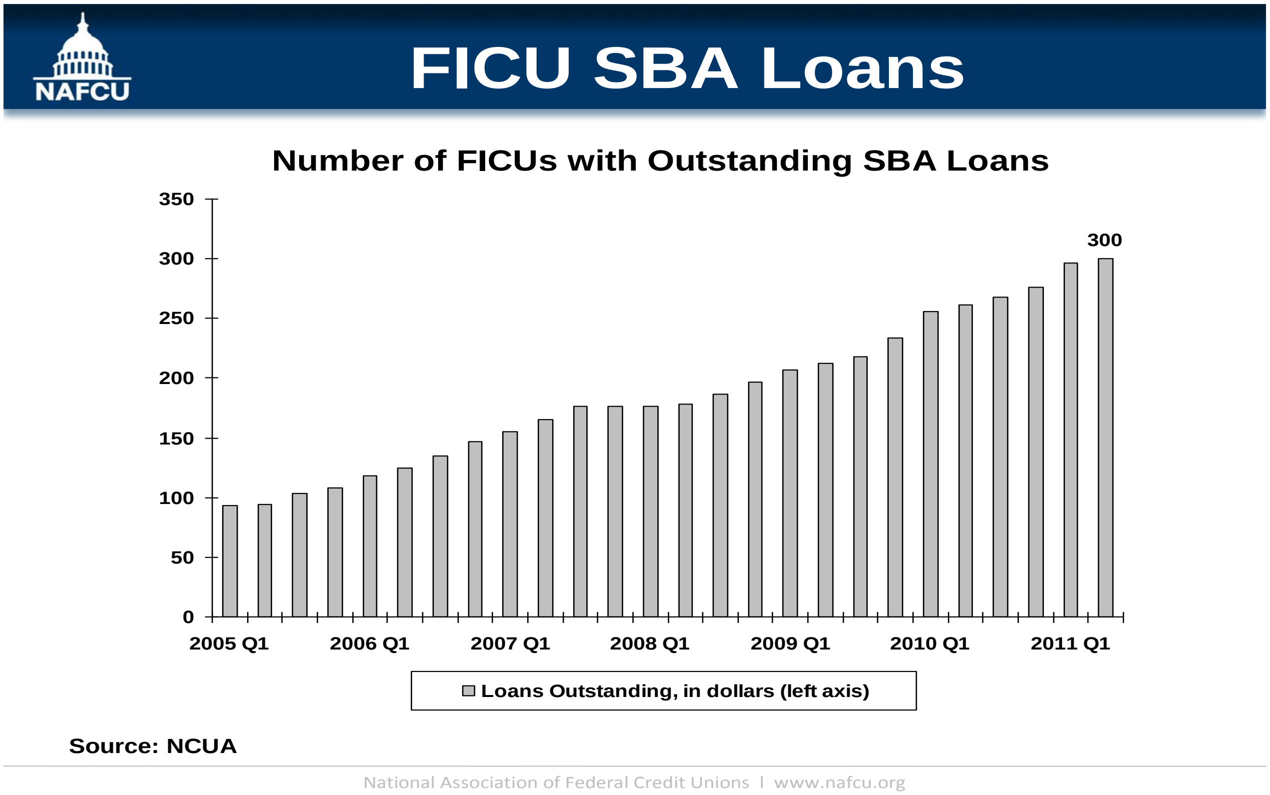
Much of the decrease in SBA lending can be associated with the overall economic downturn the nation as a whole has experienced. However, some credit unions tell NAFCU that they have scaled back on the number of small loans as a response to comments from the SBA and its examinations.

On one hand, the SBA vigorously encourages granting small loans to qualifying businesses, yet, on the other, the agency matter-of-factly states that a lender's status with SBA can be rescinded or imperiled if these higher risk loans default. The SBA provides a Lender Portal and a lender 'score' derived from SBA's Credit Risk Assessment Model. While this information is useful, it would be more beneficial for a lender to see how they compare to other lenders with similar loan portfolios. A lender's 'score' is derived by averaging other lenders', mostly large 7a loans, with small SBA Express loans. The blending of all lenders with varying portfolios to arrive at a 'score' dilutes the true picture as one cannot compare a small SBA unsecured working capital line of credit with a large SBA loan secured with commercial real estate. Clearly the two loans are different and should have different evaluation processes. If this evaluation process is not changed, it may eventually eliminate all small loans from lenders portfolios. NAFCU members have requested that the SBA via the Office of Credit Risk Management address this deficiency. A level playing field, along with more accurate information being dispensed, is critical to participating lenders in order to determine the soundness of their respective SBA loan portfolios. We hope that the Small Business Committee will be able to help in this regard as well.

As mentioned above, at Corning Credit Union our portfolio includes SBA 7(a) loans, Patriot Express and SBA Express Loans. We are fortunate that we have hired an experienced SBA lending officer with knowledge of the system to help run our program. Still, one of the hurdles that we see is that, as a general and not “preferred” lender, our local SBA 7(a) loan applications are sent off to national offices for review by underwriters who may not have a handle on a local economy. This impersonal step also adds time to the process. Additionally, this approach could discourage those lenders who do not have the expertise we do on their staff, as they are not likely dealing with a local person to help them through the process of preparing all of the paperwork. This makes it harder for those institutions that may want to do SBA loans, but would only have limited volume. As a result, some credit unions in this situation may opt not to get involved in SBA lending at all.

There is a way that this concern can be addressed. NAFCU supports the reintroduction of the *Credit Union Small Business Lending Act*, which was first introduced by Representative Velazquez in the 110th Congress. The bill would amend the *Federal Credit Union Act* to exclude any SBA loan (guaranteed and non-guaranteed portions) from the meaning of "member business loan" of a credit union. These loans would thereby be exempted from the arbitrary credit union member business lending cap. It would also amend the Small Business Act to direct the SBA Administrator to implement a program to: (1) provide outreach and assistance to credit unions to increase their participation in the SBA small business loan program; (2) simplify the application process for such participation; (3) provide a guarantee of up to 85% for loans made by credit unions to their members in underserved areas; and, (4) clarify the participation of credit unions to in the SBA’s 504 loan program. These steps would make it easier for credit unions to become more involved in SBA lending and open the door to more access to credit for those small businesses and communities served by credit unions.

As you can see from the chart below, the number of federally-insured credit unions participating in SBA programs has been steadily increasing since the SBA opened up its programs to more credit unions in 2003. Enacting legislation such as the *Credit Union Small Business Lending Act* will help this trend continue.



If Congress and the SBA were to make it easier for credit unions to participate in these programs, small businesses throughout the nation will have greater access to capital at a time when it is needed most. While we support SBA loans being permanently exempted from counting against a credit union's MBL cap, we also would support efforts to temporarily increase the guarantee on SBA loans. Our experience indicates that the recent SBA fee reductions and temporary guarantee increase helped the small businesses in our market.

These suggested changes, which allow credit unions to do more to help our nation's small businesses, are an important step to help our nation recover from the current economic downturn.

Conclusion

Small businesses are the driving force of our economy and the key to its success. The ability for them to borrow and have improved access to capital is vital for the job creation that will lift our nation out of the economic malaise in which we find ourselves today. And while the Small Business Administration's financial programs are providing much needed opportunities to established and fledgling businesses, there are still obstacles withholding the programs from their full potential. We are confident this Committee will do what is necessary to ensure that these programs are successful, while ensuring eligibility requirements and other qualifying criteria aren't overly burdensome on the financial institutions that participate in them.

We thank you for your time and the opportunity to testify before you here today on this important issue to credit unions and our nation's economy. I would welcome any questions that you may have.